



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

Release Number: **201405024**

Release Date: 1/31/2014

Date: November 8, 2013

UIL Code: 501.03-00

501.35-00

501.03-08

501.33-00

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Because you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file. File the returns in accordance with their instructions, and do not send them to this office. Failure to file the returns timely may result in a penalty.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at

1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Karen Schiller  
Acting Director, Exempt Organizations  
Rulings and Agreements

Enclosure  
Notice 437  
Redacted Proposed Adverse Determination Letter  
Redacted Final Adverse Determination Letter



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

Date: September 27, 2013

UIL: 501.03-00  
501.03-08  
501.33-00

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

**LEGEND:**

State:

Date 1:

Date 2:

Resources:

Providers:

Trustee 1:

Trustee 2:

Trustee 3:

Trustee 4:

Company:

X:

Y:

Dear :

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code § 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under § 501(c)(3). The basis for our conclusion is set forth below.

**FACTS**

You were organized under the laws of State on Date 1. You filed Form 1023, Application For Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, on Date 2.

Your Certificate of Incorporation (Certificate) states that you are organized and operated exclusively for charitable and educational purposes within the meaning of § 501(c)(3). Specifically, you organized "to facilitate organizing [Resources] for consumption by teachers and students to reduce spending on textbooks and provide improved learning opportunities." Resources are educational materials such as textbooks, seminars, lectures, and on-line courses available to the public under a Creative Commons open source license. You state that your

goal is to "serve as the primary purveyor, curator and provider of [Resources] and information." You state that you intend to accomplish this goal by performing the following activities:

- Building courses using [Resources] and curating materials on the [Company] website that will engage students in the learning process and excite teachers about the new possibilities in the [Resources] world.
- Engaging [Resources] providers in conversation about the best way to deliver [Resources] to both students and teachers alike.
- Establishing a website that helps to keep the [Resources] community informed of developments, including news, copyright decisions, conferences, professional development opportunities, and new research in the field.
- Supporting and encouraging excellent middle and high school teachers who would be willing to record their lectures and publish their ancillary materials to [the Company website].
- Developing relationships with the general public, private foundations and public charities, and governmental entities and raising funds from those persons and organizations whom would be willing to help support the organization and the proliferation of [Resources].
- Providing seminars, webinars and other special events targeting the educational and [Resources] communities and encouraging participation from individuals, corporations and governmental entities in fostering, promoting and expanding the drive for more [Resources].

Your primary activity is organizing Resources into sets of course materials and collections that are freely downloadable using Company's website and tablet applications. The first step in this process is for your researchers to "find and collect the highest-quality [Resources] in digital form from reputable not-for-profits, colleges and universities, and government websites." Resources providers include Providers. Next, your researchers use these materials to construct your courses. Your researchers either have expertise in or have been former educators in their particular subject area. You state that your courses can cover a full year of a single subject or can simply be a compilation of related materials. Some courses specifically address Common Core Standards for Math and English Language Arts. The Common Core Standards is an initiative sponsored by the National Governors Association and the Council of Chief State School Officers to standardize state educational curricula. You offer more than forty courses in middle- and high-school mathematics, science, history, language arts, and literature. You also offer numerous "reader" collections, each of which contains four to five works of famous authors' most popular works in both PDF and audio format. You state that neither you nor Company charge for the use of your courses and collections because the materials used to create these resources is published under a Creative Commons license that does not allow commercial redistribution. Next, schools and teachers use your courses as a template in developing their specific course content. Finally, students download the tailored courses on their computers or tablets for use in and out of the classroom. You state that you spend approximately 65 percent of your total time and resources creating your courses.

You distribute your course through the Company website using Company's website and tablet applications. The applications are available to the public for free. You state that your courses could be distributed through other means but that "the [free Company] portal continues to

provide [you] with the most effective way to reach hundreds of educators and schools and to carry out your mission of organizing and promoting the use of [Resources]."

You have a licensing agreement with Company that permits you to use Company's website and tablet applications royalty free for your charitable and educational purposes. This agreement (and Creative Commons license) prohibits Company from charging the public to download your courses. Accordingly, all of your courses are available for free through Company's website and tablet applications.

Company provides consulting services to help schools use the Company website to improve their education content delivery. Company services include creation of baseline course content specifically mapped to the school's curriculum, discounted access to copyrighted content, onsite and webinar trainings, and online, e-mail, and telephone support. You state that Company charges above cost for these services. Company has provided its services to at least two schools. In one contract, Company charged a fixed contract price of \$2x per student for the first year of service and \$x per student for each subsequent year. In another contract, Company charged a flat fee of \$y. You do not state whether Company restricts its consulting services to § 501(c)(3) organizations.

Your Board of Trustees manages your affairs. Currently, your Board of Trustees consists of four Trustees—Trustee 1, Trustee 2, Trustee 3, and Trustee 4. Trustee 1 and Trustee 2 are the only shareholders of Company, a for-profit subchapter S corporation. Accordingly, Trustee 1 and Trustee 2 control Company. Trustee 1 and Trustee 2 are also your and Company's sole contributors. You and Company share the same address.

Trustee 1 and Trustee 2 formed Company after the introduction of tablet computers to create software to help organize and publish Resources. During Company's pilot project, Company discovered that the teachers "needed assistance in finding and organizing educational material from the internet." Accordingly, Trustee 1 and Trustee 2 incorporated you "as a management vehicle for this work." You state that your formation as a non-profit entity made sense because you cannot charge for Resources under the Creative Commons license. You explain that you "felt two separate entities, a for-profit focused on the software systems, and a non-profit focused on helping educators use [Resources], was the most appropriate model."

You have adopted a conflict of interest policy. However, you state that Trustee 1 and Trustee 2 did not abstain from the decision to select Company as the distribution vehicle for your courses. Additionally, you state that you did not solicit competitive bids from companies other than Company to produce software to distribute your programs. Rather, you state that "at the time . . . there were no other viable alternative options available for [you] to distribute [your] courses and content." You further state that "[e]ven today, no other system has the capability of Company."

## LAW

I.R.C. § 501(c)(3) exempts from federal income taxation any corporation organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals, provided no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Treas. Reg. § 1.501(c)(3)-1(a)(1) provides that, in order to be described in I.R.C. § 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in that section. If an organization fails to meet either the organizational or operational test, it is not exempt.

Treas. Reg. § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in I.R.C. § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. To meet the requirement of this subsection, the burden of proof is on the organization to show that it is not organized or operated for the benefit of private interests, such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treas. Reg. § 1.501(c)(3)-1(d)(2) provides that the term "charitable" is used in I.R.C. § 501(c)(3) in its generally accepted legal sense and includes, among other things, lessening the burdens of government, relief of the poor and distressed or of the underprivileged, advancement of education or science, erection or maintenance of public buildings, monuments, or works, and promotion of social welfare by organizations designed to accomplish any of the above purposes, or in part to defend human and civil rights secured by law.

Rev. Rul. 66-147, 1966-01 C.B. 137, determined that an organization formed to survey scientific and medical literature published throughout the world and to prepare and distribute abstracts of that literature free of charge qualified for recognition under § 501(c)(3). The organization employed technical personnel with expertise in the fields of medicine, chemistry, and biology to survey and write abstracts about the scientific and medical literature. The organization compiled the abstracts in monthly publications that it distributed, free of charge, to anyone having particular interest in the subject matter. The ruling held that reviewing medical and scientific publications and preparing and disseminating free abstracts of meaningful and accurate reference materials based on articles appearing in such publication were programs that advance education and science.

Rev. Rul. 67-4, 1967-1 C.B. 121, determined that an organization formed for the purpose of encouraging basic research in specific types of physical and mental disorders, to improve educational procedures for teaching those afflicted with such disorders, and to disseminate educational information about such disorders, by the publication of a journal containing current

technical literature relating to these disorders qualified for recognition under § 501(c)(3). The organization's staff consisted of leading pathologists, other medical specialists, and teachers, most of whom donated their services. The organization published a journal, which was sold to the public below cost, containing abstracts of current information from the world's medical and scientific publications. The ruling held that the methods used for preparing and presenting the abstracts conformed to methods traditionally accepted as "educational" in nature. Furthermore, the organization distributed the abstracts in a "charitable" manner, in the sense that there is a public benefit derived from the distribution and charges for the publication only covered a portion of the costs.

Rev. Rul. 70-129, 1970-1 C.B. 128, determined that an organization formed for educational and scientific purposes to support research in anthropology by manufacturing high quality cast reproductions of anthropological specimens qualified for recognition under § 501(c)(3). Qualified scientific personnel oversaw the manufacture of these reproductions. The organization sold the reproductions to scholars and educational institutions in a noncommercial manner to recoup costs and expenses. The organization solicited contributions to defray any operating deficits. The ruling determined that examination of anthropological specimens was an important step in anthropological education and research. Furthermore, the manufacture and sale of accurate reproductions provided an effective means for making these important research and study aids generally available. Therefore, the ruling held that the distribution of these reproductions accomplished the dissemination of important educational and scientific information. The charging of fees for the reproductions did not preclude recognition under § 501(c)(3) because distribution was distinguishable from ordinary commercial practices.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of private benefit, if substantial in nature, will destroy an organization's tax-exempt status regardless of the organization's other charitable purposes or activities.

In Church by Mail v. Commissioner, 765 F.2d 1387 (9th Cir. 1985), the United States Court of Appeals for the Ninth Circuit determined that a church operated for the substantial non-exempt purpose of providing a market for a related for-profit organization's services. Additionally, the court found it unnecessary to consider the reasonableness of payments made by the church to the for-profit business. Instead, the court stated that "[t]he critical inquiry is not whether particular contractual payments to a related for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the Church."

In est. of Hawaii v. Commissioner, 71 T.C. 1067 (1979), the Tax Court determine that two related for-profit organizations benefitted from petitioner's operation. In short, the court determined that "petitioner's only function is to present to the public for a fee ideas that are owned by [a related for-profit organization] with materials and trainers that are supplied and controlled by [another related for-profit organization]." Furthermore, the court stated that compensation need not be unreasonable or exceed fair market value for private benefit to exist.

In P.L.L. Scholarship v. Commissioner, 82 T.C. 196 (1984), the Tax Court found that an organization that operated charitable bingo on the premises of a bar allowed the bar to increase its sales of food and drinks by its operation in the bar, thereby benefitting the bar in more than

an insubstantial way. The organization and bar were controlled by some of the same persons. The court held that the operations of the organization and bar were so interrelated as to be "functionally inseparable," the effect of which was that any economic benefit the bar received was not incidental.

In American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989), the Tax Court determined that the American Campaign Academy, a training program for political campaign professionals, operated for the private benefit of the Republican party because its tailored its curriculum to Republican interests, its graduates worked for Republican candidates and incumbents, and Republican sources financed it. The Tax Court defined private benefit as "nonincidental benefits conferred on disinterested persons that serve private interests." Private benefits included "advantage; profit; fruit; privilege; gain; [or] interest."

In International Postgraduate Medical Foundation v. Commissioner, 56 T.C.M. (CCH) 1140 (1989), an organization that conducted continuing medical education tours abroad exclusively used a for-profit travel agency to arrange its travel tours. The same individuals controlled both the organization and the for-profit travel agency, and the organization did not solicit bids from any other travel agency. Furthermore, both entities shared the same office. As both entities were interrelated, the court held that the organization was operated for the benefit of the for-profit travel agency.

## RATIONALE

An organization seeking tax-exempt status under § 501(c)(3) must be organized and operated exclusively for charitable or other exempt purposes with no part of its net earnings inuring to the benefit of any private shareholder or individual. See Treas. Reg. § 1.501(c)(3)-1(a)(1). An organization is "operated exclusively" for one or more exempt purpose only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in § 501(c)(3). Treas. Reg. § 1.501(c)(3)-1(c)(1). The presence of a single, substantial non-exempt purpose will destroy the exemption regardless of the number or importance of any truly exempt purposes. Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945). The materials you submitted state that you are seeking recognition of tax-exempt status under § 501(c)(3) as a charitable organization advancing education. Based on a review of your activities, you are not described in § 501(c)(3) because you operate for one or more substantial non-exempt purposes.

Section 501(c)(3) uses the term "charitable" in its generally accepted legal sense. Treas. Reg. § 1.501(c)(3)-1(d)(2). The term "charitable" includes advancement of education. Id. For example, publishing abstracts of scientific and medical articles advances education by providing an effective means for the increased dissemination and application of such knowledge. Rev. Rul. 67-4; Rev. Rul. 66-147. Additionally, disseminating reproductions of anthropological specimens advances education by making these important research and study aids generally available. Rev. Rul. 70-129. Here, your primary activity is finding and organizing Resources into courses. The researchers compiling these courses either have particular expertise in or have experience as former educators in their particular subject. Some courses specifically address Common Core Standards for Math and English. You publish these courses without charge for teachers to use in teaching particular subjects or topics or in developing their own course content. Accordingly, your activities advance education because you make Resources



generally available to the public and because your courses provide an effective means for the increased dissemination of Resources.

However, in order to qualify for tax-exempt status under § 501(c)(3), you must also establish that you are not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). A private benefit occurs when a tax-exempt organization operates for the benefit of a related for-profit entity. Church by Mail v. Commissioner, 765 F.2d 1387 (9th Cir. 1985); P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196 (1984); est of Hawaii v. Commissioner, 71 T.C. 1067 (1979); International Postgraduate Medical Foundation v. Commissioner, 56 T.C.M. (CCH) 1140 (1989). Such benefit need not be strictly monetary. For example, in American Campaign Academy v. Commissioner, the Tax Court determined that the American Campaign Academy, a training program for political campaign professionals, operated for the substantial private interest of the Republican Party because its tailored its curriculum to Republican interests, its graduates worked for Republican candidates and incumbents, and Republican sources financed it. 92 T.C. 1053 (1989).

You operate for the substantial private benefit of Company, a for-profit organization. Trustee 1 and Trustee 2, two of your four trustees, are the sole shareholders of Company. As such, Trustee 1 and Trustee 2 control Company. Additionally, you and Company share the same address. You did not solicit competitive bids from companies other than Company to produce software for the distribution of your courses. Instead, you were formed for the sole purpose of finding and organizing courses for use on Company's website and tablet applications.

Company does not charge for use of its website or tablet applications. Furthermore, under the licensing agreement, Company may not charge for your courses. However, Company offers consulting services to schools to help implement its website and tablet applications in the classroom. You state that Company charges above cost rates for these services. Company has provided its consulting services to at least two schools. Under one contract, Company charged \$2x per student for the first year of service and \$x per student for each subsequent year. Under another contract, Company charged a flat fee of \$y. Company does not limit its services to § 501(c)(3) organizations. Therefore, Company derives a benefit from your activities.

Incidental private benefit is permissible when it is an unintentional and unavoidable consequence of charitable activity. However, this is not the case here. The benefit that Company receives is significant and not incidental because you provide all the content for Company's website and tablet applications. Therefore, you operate for the substantial private benefit of Company, and, through Company, Trustee 1 and Trustee 2.

## CONCLUSION

Based on the above, we have determined that you fail to meet the requirements necessary to be recognized as a tax-exempt organization under § 501(c)(3). You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of

your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination.

**Your protest statement should be accompanied by the following declaration:**

*Under penalties of perjury, I declare that I have examined this protest statement, including accompanying documents, and, to the best of my knowledge and belief, the statement contains all the relevant facts, and such facts are true, correct, and complete.*

**This declaration must be signed by an elected officer, a member of the board of directors, or a trustee rather than an attorney or accountant.**

You also have a right to request a conference to discuss your protest. This request should be made when you file your protest statement. An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you. If you want representation during the conference procedures, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. For more information about representation, see Publication 947, *Practice before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at [www.irs.gov](http://www.irs.gov), Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to protest as a failure to exhaust available administrative remedies. Section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848 and any supporting documents to this address:

Internal Revenue Service  
TE/GE (SE:T:EO:RA:T3)

You may also fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Karen Schiller  
Acting, Director, Exempt Organizations  
Rulings and Agreements